

Chesapeake Utilities Corporation



Regulation Docket No. 59 Revenue Decoupling Mechanisms

May 16, 2007

PSC Regulation Docket No. 59

Revenue Decoupling Mechanisms

Overview

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Overview

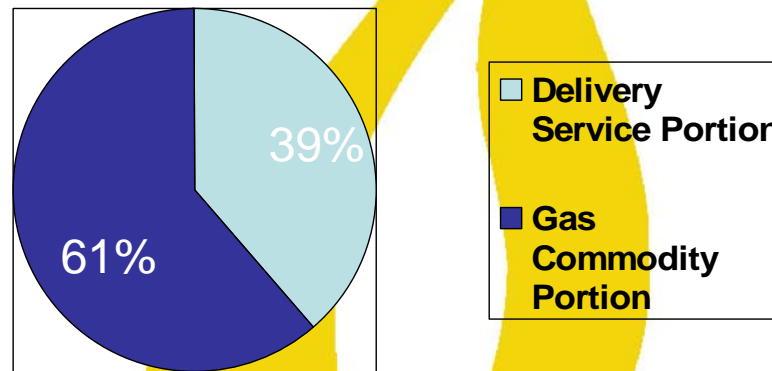
- Revenue decoupling is a rate design that allows utilities to actively promote energy efficiency while mitigating the erosion of margins that is the usual outcome of conservation and energy efficiency.
- Mechanisms include Straight-Fixed Variable rate design, Fixed delivery service charge, Weather Normalization Mechanisms, Revenue Normalization Mechanisms and Rate Stabilization Mechanisms
- Revenue normalization mechanisms break the link between a utility's earnings and the energy consumption of its customers while maintaining the volumetric nature of the rate design.
- Gas utility bills are generally separated into two components; delivery service and gas commodity service.
- According to the American Gas Association (AGA), currently 17 utilities in 10 states have implemented decoupling tariffs while another 10 states have decoupling programs pending.
- Decoupling tariffs have been implemented in the surrounding states of New Jersey and Maryland, including Chesapeake's operating division in Maryland.

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Overview

**Chesapeake Utilities Corporation
Typical Residential Heating Bill**



- **Delivery service portion of a customers bill is subject to revenue decoupling (39%)**
- **Gas commodity portion and other variable components of a customers bill varies with energy conservation efforts (61%)**

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Overview

- Adds to the tariffs a symmetrical tracking mechanism that is similar to weather normalization adjustment mechanisms and that “true-up” the volumetric distribution charge.
- When sales volumes decline from the level forecasted in the rate case, the true-up mechanism increases the distribution charge.
- When sales volumes increase from the level forecasted in the rate case, the true-up mechanism decreases the distribution charge.
- The decoupling true-up adjustment is a proportional mechanism. The amount of “true-up” cost assigned to each customer is proportional to the customer’s individual usage. High volume customers pay more of the true-up charge than do low-volume customers.
- Decoupling prevents the utility from increasing its earnings by increasing its sales volumes per customer because with revenue decoupling any additional distribution revenues over and above the level forecasted in the rate case is refunded to customers.

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- **Natural gas utilities provide a service, not a product.**
 - **Traditional rate design implies that utilities can recover their costs only if customers consume a fixed amount of gas.**
 - **Traditional rate designs contain a financial disincentive for aggressively promoting energy efficiency and conservation.**
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Potential Benefits for the Consumer

- **Decoupling imposes no additional costs to the customer beyond those approved in the rate case.**
- **Decoupling leads to reduced bill variability.**
- **Reduced natural gas consumption from conservation leads to lower total energy bills.**
- **Possible reduction in uncollectible bills, which are a system cost paid by customers.**

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Impact on Cost of Capital

- **Rate design change decouples return recovery from commodity sales volumes.**
- **The symmetrical nature of decoupling decreases over-earning at the same time that it lessens under-earning.**
- **Company is not sheltered from impact of increased costs.**
- **Decoupling does not provide a guarantee that company will achieve its authorized ROE.**
- **Peer group for cost of capital determination may already include companies with innovative rates.**
- **Factors determining cost of capital generally don't include rate design.**

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Chesapeake Experience and Program

- **Chesapeake decoupling mechanism approved by Maryland PSC to be effective October 2006.**
- **Annual delivery service margin established for residential and small commercial customers during rate case proceeding.**
- **Annual delivery service margin is distributed into monthly revenue levels against which actual delivery service margin is measured.**
- **Any over or under recovery is accrued each month and included on customer bills each quarter.**
- **Granted Return on Equity of 10.75%.**
- **According to Maryland PSC Senior Staff member, the BG&E program that was initiated around 8 years ago has achieved the intended objectives including reduced volatility in gas bills.**
- **Overall, this Staff member concluded that the mechanism has “fulfilled more regulatory objectives with fewer shortcomings than other alternatives.”**

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Chesapeake Maryland Examples

- **January 2007 (24% warmer than normal)**
- **A residential heating customer using 33% less natural gas for the month paid \$48 (23%) less than what was authorized in the rate case with revenue decoupling**

	Typical Customer (Rate Case)	Actual Average Customer w/ Decoupling	Actual Average Customer w/o Decoupling
Monthly Consumption (Ccf)	104	70	70
Delivery Service Revenue	\$62	\$62	\$52
Gas Cost Rate per Ccf	\$1.401	\$1.401	\$1.401
Gas Cost Revenue	\$146	\$98	\$98
Total Bill	\$208	\$160	\$150
Decrease in Bill		\$48	

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Chesapeake Maryland Examples

- **February 2007 (17% colder than normal)**
- **A residential heating customer using 13% more natural gas for the month paid \$20 (9.5%) more than what was authorized in the rate case as a result of revenue decoupling**

	Typical Customer (Rate Case)	Actual Average Customer w/ Decoupling	Actual Average Customer w/o Decoupling
Monthly Consumption (Ccf)	108	122	122
Delivery Service Revenue	\$60	\$60	\$67
Gas Cost Rate per Ccf	\$1.401	\$1.401	\$1.401
Gas Cost Revenue	\$151	\$171	\$171
Total Bill	\$211	\$231	\$238
Increase in Bill		\$20	

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Closing Summary

- **United States Senate Bill 1115 urges state regulators to allow utilities to decouple their revenues from their gas sales.**
- **Acting Director of the American Council for an Energy Efficient Economy indicated that the Senate Panel's action was a good first step in encouraging consumers to conserve energy.**
- **American Gas Foundation and National Association of Regulatory Utility Commissioners (NARUC) issue whitepaper promoting revenue decoupling**